**CMCE response to the FCA's Consultation Paper (CP25/19) on the Ancillary Activities Test**

**27 August 2025**

## Opening remarks

The Commodity Markets Council Europe (CMCE) welcomes the opportunity to respond to the Financial Conduct Authority's (FCA) Consultation Paper (CP25/19) on the Ancillary Activities Test (AAT).

CMCE represents a broad cross-section of firms active in European and global commodity derivatives markets, including commodity trading companies, energy firms, utilities, and trading venues. Our members are deeply embedded in physical supply chains and play a vital role in ensuring energy security, food supply, and the transition to a low-carbon economy. Many of these firms are non-financial counterparties (NFCs) whose use of commodity derivatives is primarily for hedging commercial risks associated with their real economy activities.

CMCE supports the FCA's aim of ensuring a proportionate and effective perimeter regime for commodity derivatives activity in the UK, consistent with broader objectives for financial stability, market integrity, and competitiveness. We appreciate the FCA's engagement to date and its efforts to consult publicly on options for reforming the AAT, following the UK's departure from the EU.

That said, we believe that several aspects of the consultation require further refinement and clarification to ensure the resulting regime remains workable and proportionate for firms whose core business is not financial in nature. These include the treatment of exchange-traded derivatives (ETDs), the scope of the de minimis threshold, and the structure and application of the two alternative tests. CMCE members want to state clearly, as emphasised in our response to Question 1, that the tests should capture only cash-settled contracts, defined explicitly as such, and that this limitation should be unambiguously reflected in the final drafting.

In this response, CMCE sets out its views on the key components of the proposed AAT framework. We advocate for a flexible approach that allows firms to apply the most appropriate of the two proposed tests, supports a pragmatic treatment of trading on UK trading venues, and one which supports economic growth in the UK financial services sector and, therefore, strongly opposes the inclusion of trading on UK trading venues within the threshold unless accompanied by a substantially higher threshold and robust justification.

**Drafting Concerns**

We highlight immediately below some technical drafting concerns on the proposed draft Handbook text, which are driven by inconsistencies (and potential inconsistencies) between that text and primary legislation, introducing legal uncertainty. In particular, we also recommend greater alignment between the Handbook text and the FSMA 2000 (Regulated Activities) Order 2001 (the "**RAO**") to preserve legal certainty, which is critical for the utility of this exemption.

**Annex B: Proposed Amendments to MAR:**

*Application Section MAR 10A.1.3R to 10A.1.5R*:

- The function of this section is to determine to the kinds of person to whom the chapter applies. In practice, that amounts to "any person" – it is not necessary formally to limit the application of this chapter, as its effect is to supplement the Level 1 ancillary activity text at Schedule 3 to the RAO. We would suggest simply stating that the chapter applies to any person, as a Rule; and then, perhaps in Guidance, making it clear that it will be *relevant* to any person seeking to rely on the ancillary activity exemption set out a paragraph 1(k) to Schedule 3 to the RAO.
- Sections 10A.1.3R to 10A.1.5R could then be deleted, as they add nothing to the text of Schedule 3 to RAO.
- We appreciate that the FCA Handbook editorial style means that, for example, when the RAO text is restated in these provisions, terms (like "dealing on own account" "market maker", "person", "commodity derivatives", "emission allowances" and "investment services") are presented in italicised form, linking them to FCA Glossary definitions and not leaving them to be determined by reference to the interpretation provisions in the RAO. That approach, however, creates the conditions for legal uncertainty. That uncertainty could be avoided, either by not restating the text or, if the FCA feels it wishes to place all the relevant material in one place (to be user-friendly), by *quoting* the RAO text word for word and not restating it in FCA Glossary terms.
- We note, in particular, that 10A.1.3R not only restates the RAO text, but introduces an element which is not present in the RAO. This is the proviso that the activity *"is carried on from an establishment in the United Kingdom"*. There is no such proviso in the RAO text and in fact we do not agree that the RAO text would or should be interpreted as carrying this implicit limitation. The introduction of this condition is unnecessary and potentially damaging. It has the potential to limit the application of this chapter to only a subset of cases where the ancillary activity exemption should apply.
- We would strongly recommend that FCA's Handbook text does not seek to restate the RAO text, and that if FCA decides to do so, it should restrict itself to using the *exact wording* of the RAO text rather than paraphrasing or introducing new elements such as this.
- We note that FCA's power under article 2A of the RAO - as amended under the draft Financial Services and Markets Act 2000 (Regulated Activities) Order 2025 (the draft **SI**) - is limited to the making of rules:

  (a) to set the criteria for establishing when an activity is to be considered ancillary to the main business of a firm at group level under paragraph 1A(a); and
  (b) to set the annual thresholds under paragraph 1A(b) and related criteria.

This does **not** include powers to insert other elements into the ancillary activity exemption. It is limited only to fleshing out the tests under paragraph 1A. The introduction of a proviso limiting the application to activity carried on from a UK establishment is therefore not covered by the powers under the draft SI. We also note that FCA has not discussed this potential change in CP25/19 and did not ask questions on it.

We highlight certain other drafting concerns in the responses to specific questions below, but have set this point out here, as it is relevant to the application of the ancillary activity exemption under paragraph 1(k) as whole.

**Q1: Do you agree with the approach outlined above to allow firms to choose one of the following tests: i) annual threshold test ii) trading test iii) capital employed test? If not, please explain why.**

CMCE answer

CMCE agrees in principle with the FCA's proposal to offer firms a choice between the annual threshold test, the trading test, and the capital employed test as a means of determining whether they are dealing on own account. Providing multiple pathways can help ensure the regime remains proportionate and adaptable to the diverse business models and risk profiles of firms operating in commodity derivatives markets.

That said, CMCE has concerns, as noted above in the Opening Remarks section of this response, regarding the associated draft Handbook text, where it seeks to paraphrase key aspects of Level 1 legislation. Introducing such changes risks creating legal uncertainty and confusion among firms.

The integrity of the AAT as a perimeter tool depends not only on the availability of clear, appropriate tests, but also on legal clarity and consistency in how the test is applied, and we therefore urge FCA to reconsider the drafting in the light of our comments.

In addition, CMCE encourages the FCA to clarify in its final guidance that the three tests are alternatives and that applying more than one test is optional, with the choice of test left to the discretion of the market participant based on its business structure and activities. This will provide operational certainty and reduce unnecessary compliance burden.

Moreover, CMCE strongly welcomes the FCA's clarification that spot and physically settled emission allowance contracts will be excluded from the AAT threshold. This is a critical and appropriate distinction that reflects the market reality of how emission allowances are traded and used - namely, as instruments to fulfil compliance obligations under emissions schemes rather than for being traded for speculative purposes. Including such contracts would have imposed an unjustified regulatory burden on firms that are actively

participating in decarbonisation and emissions reduction efforts. The proposed exclusion therefore supports the UK's environmental policy objectives as well as its competitiveness agenda.

This approach is also consistent with international best practice, as well as the feedback CMCE provided in earlier engagement with the FCA. It is essential that this clarity be preserved in the final rules.

However, CMCE urges the FCA to clarify the drafting in MAR 10A.3.1R(4) which provides that relevant contracts "for cash-settlement must include all such derivative contracts relating to commodities or emission allowances which must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event". The use of the phrase "*must include*" (as opposed to "*comprise*") suggests that other contracts could be regarded as for cash settlement, which we believe – and trust – is not FCA's intention here. To introduce this undermines the certainty, precision and utility of the threshold test, and risks including physically-settled ETDs and OTC derivatives into the test, which would radically change the scope and application of that test, not reflecting FCA's intention as we understand it.

The exclusion of physically-settled commodity derivatives and emission allowances is vital to the utility of this threshold test. These contracts, particularly those linked to physical delivery of energy, metals or agricultural products, are fundamental to commercial hedging and supply chain management. Including them would distort the purpose and scope of the annual threshold test from the existing test and the way it is being applied and have the unintentional effect of inadvertently capturing firms or activity which FCA does not intend to capture. We therefore urge FCA to replace the words "must include" with "comprise" or "are limited to", to put the matter beyond doubt.

**Q2: Do you consider that trading conducted on a trading venue should be included in the annual threshold test? Please explain your rationale.**

CMCE answer

CMCE strongly opposes the inclusion of trading conducted on UK trading venues within the scope of the annual threshold test under the AAT. This represents a significant and unanticipated shift in the regulatory perimeter, one that was not signalled in prior FCA-industry engagement, and which has raised considerable concern among members. In previous discussions, the FCA indicated that it did not intend to change the scope of firms caught under the ancillary activity exemption; however, this proposal would materially alter that scope, expand the perimeter, and place it out of alignment with those earlier assurances. This concern is shared not only by commodity market participants generally, but also expressly by trading venue members, who see this change as directly undermining the competitiveness of UK markets.

From a policy and competitiveness perspective, this proposal risks placing UK-based firms and UK trading venues at a material disadvantage relative to their international peers.

- Many UK commodity firms conduct most of their trading on UK trading venues, contributing directly to the competitiveness and liquidity of domestic markets. Capturing such trading within the threshold calculation, particularly when these trades are often risk-reducing or physically settled, would distort firms' regulatory status in a way that is not reflective of their actual market footprint or systemic relevance.
- Including volume on UK trading venues in the annual threshold test would, moreover, disincentivise firms from trading on UK trading venues to avoid being regulated as investment firms. This would be disproportionate, as it risks capturing even the smallest firms, and would be potentially damaging to the economic growth of UK financial markets. By decreasing liquidity on UK trading venues, it could also drive volatility and inhibit price discovery unnecessarily.
- Firms seeking to rely on the annual threshold test would have to develop IT and compliance systems to calculate the net outstanding notional amount on such venues (even if the threshold is set fairly high), which effectively imposes an additional cost for firms choosing to bring their volume to UK trading venues, and therefore disadvantages those venues against their international competitors.

The inclusion of UK trading venue activity is inconsistent with prevailing international standards, including the EU's framework under MiFID II and MiFIR, where the location of the trading venue is not determined for the purposes of the de minimis test under the ancillary activity exemption. The UK has rightly expressed a desire to maintain a globally competitive financial services regime post-Brexit. However, this proposal appears to run counter to that goal by embedding an unnecessarily restrictive perimeter that would penalise firms for trading domestically.

If the FCA chooses to proceed with this approach, CMCE urges that it be accompanied by a substantial uplift in the threshold to ensure that firms are not inadvertently brought into the regulatory perimeter due solely to operational choices about venue access. Without such adjustment, the inclusion of UK venue trading would act as a disincentive to use UK markets, undermining their attractiveness and potentially driving liquidity offshore, an outcome clearly at odds with the broader UK financial services and competitiveness strategy.

We encourage the FCA to revisit this issue in light of its broader policy objectives, and to exclude volume on UK trading venues from the annual threshold test.

**Q3: If the annual threshold test incorporates trading conducted on a trading venue, which option do you prefer from paragraph 3.37 and 3.38, approach 1 or 2? Further, do you agree**

**with the level of the threshold proposed in respect of each option in paragraphs 3.52? If not, please explain why.**

CMCE answer

CMCE continues to strongly oppose the inclusion of trading activity conducted on UK trading venues in the scope of the annual threshold test. This proposal was not signalled in prior engagement and risks undermining the competitiveness of UK commodity markets. If firms are penalised for using domestic venues, they may be incentivised to shift trading offshore, fragmenting liquidity and weakening the UK's position as a global centre for commodities.

CMCE strongly encourages the FCA to consider allowing both approaches to be retained as alternatives, giving firms the flexibility to apply the method most appropriate to their trading and clearing structure.

However, if the FCA proceeds with including venue activity despite these concerns, CMCE believes that Option 2 (as set out in paragraph 3.38) as currently framed is not usable and risks unintended consequences. If Option 2 were amended to address *all* the issues highlighted below, it may be preferable to Option 1, but if it is not so amended it could be problematic.

- Option 1 includes all activity in contracts for cash settlement on UK trading venues and applies a higher threshold (e.g. £5 billion). For the reasons given in the previous answer, CMCE does not support this approach, as it inappropriately captures legitimate activity conducted on UK markets, including by firms that are clearly non-systemic, and could bring them into the regulatory perimeter solely due to their choice to bring their volume onto a UK trading venue.
- Option 2, which excludes trades executed with or through "FCA-authorised firms" and applies a lower threshold (e.g. £3 billion), could offer a useful alternative. However, exclusion of contracts traded on its behalf by, or with, an "FCA authorised firm" is very limited and does not adequately describe the way in which firms access trading venues.

- "FCA-authorised firm" is defined in the proposed amended FCA Glossary text as "a *firm*, to which section 424A of the *Act* applies, *authorised* to provide *investment services or activities*". (Strictly speaking section 424A does not apply to any person, it is merely a definition of the term "investment firm" when used in FSMA.) Limiting the exclusion under Option 2 to *firms* within the FSMA "investment firm" notion, however, would be highly problematic for many firms and would risk changing the scope of the AAT. In particular, Option 2 applies to capture all volume on trading venues, whether UK or overseas venues, and excludes only volume by or with "FCA-authorised firms". That means that the volume would not be excluded:

- when a firm trades on a UK trading venue using an overseas bank as a clearing member or broker;
- when a firm trades on an overseas trading venue, unless it uses a UK authorised firm as its clearing member/broker on that venue; or
- when a firm self-clears on any trading venue or clearing house (where the trading venue or clearing house is a *recognised body*, and therefore an exempt person under FSMA, rather than an authorised person).

The reality of the current market position, is that a very significant proportion of trading activity in commodity derivatives or emission allowances, which is on trading venue or OTC cleared, is cleared by non-UK clearing firms who are highly regulated in their home jurisdictions, in line with international standards.

CMCE therefore recommends that if Option 2 is retained, it should (a) exclude all activity on trading venues, whether in the UK or otherwise, and (b) replace the notion of FCA-authorised firm with a concept covering UK authorised firms, UK exempt persons acting within the scope of their exemptions, or overseas equivalents of either of the above. (We note that article 16(b) of the RAO provides an "ordinary business test" designed to identify overseas firms which are equivalents to UK authorised persons/exempt persons, for the purposes of the *"with or through"* exclusion.) Without this, Option 2 risks introducing artificial distortions and penalising standard clearing models in global commodity markets.

**Q4: Regarding the annual threshold, do you agree with the following proposals: a. currency of the threshold and, b. the methodology (outside of trades conducted on a UK trading venue) for calculating a firms net notional exposure? If not, please explain why.**

CMCE answer

CMCE broadly supports the FCA's proposals concerning the annual threshold but wishes to raise two important points of clarification and concern relating to (a) the treatment of currency conversion and (b) the methodology for calculating notional exposure under the counterparty-based test.

a. Currency of the threshold:
CMCE has no objection to the annual threshold being denominated in GBP, which is appropriate for a UK regulatory regime. However, many of our members are active in global commodity markets and conduct a significant proportion of their trading in USD or EUR. To ensure consistency and reduce operational

uncertainty, CMCE recommends that the FCA provide clear and standardised guidance on the currency conversion mechanism.

This guidance should specify:

- The source of exchange rates (e.g. Bank of England, ECB, or a designated benchmark provider),
- The frequency of conversion (e.g. end-of-month spot rate, monthly average, or annual average),
- Whether firms may apply a consistent firm-wide policy or must align with FCA-determined rates for AAT purposes.

Absent such clarity, firms risk facing inconsistent supervisory expectations or technical breaches of the threshold driven by exchange rate fluctuations, rather than meaningful changes in activity. A transparent and predictable conversion framework would support both operational efficiency and regulatory certainty.

b. Methodology for calculating net notional exposure (outside UK trading venues): As noted in the response to the previous question, CMCE has reservations about the features of both Option 1 and Option 2 of the annual threshold test and reiterates those comments here.

CMCE supports, however, the proposed text of MAR 10A.4.1R.

We note that the annual threshold test would require the net outstanding exposure to be calculated in accordance with MAR 10A.3.1R. We support this in principle, in particular we support the use of the same netting methodology as that used for the capital employed test. However, as we have noted above, the use of the phrase "must include" in MAR10A3.1R(4) should be replaced by "comprise" or "are limited to", to provide certainty and reflect the intention of the provision.

**Q5: Are there circumstances in which the annual threshold might need to be quickly amended, even with the inclusion of a reasonable risk margin (based on internal data analysis)? If yes, please explain.**

CMCE answer

CMCE does not support rapid or discretionary amendments to the annual threshold. We believe the threshold should be adjusted through a transparent, rules-based mechanism (as discussed in our response to Q6), rather than reactive changes triggered by short-term volatility or internal modelling. Sudden amendments, particularly downward adjustments, could disrupt hedging strategies, create compliance uncertainty, and undermine confidence in the UK regulatory regime. If internal FCA analysis identifies longer-

term structural shifts, these can be addressed through the normal consultation process. As part of this, CMCE would support a periodic review, for example, every five years, to adjust the threshold for inflation in a predictable manner. A stable, predictable regime is essential for firms operating in global commodity markets.

**Q6: Should our rules include a mechanism that adjusts the annual threshold due to certain factors, such as inflation? If so, please suggest on what basis this could be achieved and how frequently reviews and updates might be needed.**

CMCE answer

CMCE does not support a discretionary or ad hoc approach to revising the annual threshold. Instead, we advocate for a rules-based, automatic, and upward-only adjustment mechanism that provides long-term certainty and predictability for firms. This is essential to ensure that the AAT remains proportionate and aligned with evolving market dynamics, without introducing regulatory volatility or the risk of sudden perimeter changes.

While we acknowledge that unforeseen market circumstances could emerge, CMCE believes that such events should not trigger immediate downward revisions to the threshold. Firms often take risk-reducing or hedging positions in times of volatility, and a rapid reduction in the threshold could result in firms breaching the limit through no fault of their own, potentially forcing a withdrawal from the market or a reorganisation of commercial activity. This would be counterproductive, particularly during periods of stress when real economy firms most need access to effective hedging tools.

Instead, the threshold should be adjusted via a transparent, annual process tied to a well-defined index, for example, using a "triple-lock" style mechanism that ensures an upward-only adjustment based on:

- Consumer Price Index (CPI),
- A commodity market index, or
- Sector-specific inflation metrics,

whichever is highest. This approach would preserve regulatory stability and competitiveness while ensuring the threshold remains appropriate over time.

In summary, while rapid amendment might be conceptually justified in rare cases, CMCE strongly believes that the risks of reactive changes outweigh the benefits. The FCA should prioritise a stable, predictable framework with limited discretion to make emergency adjustments, and only in cases of genuine systemic risk.

**Q7: Do you agree with the proposal to retain the calculation methodology of the trading test and to raise the threshold? If not, please explain why.**

CMCE answer

Subject to the comments in responses to the previous questions, CMCE supports the FCA's proposal to retain the existing calculation methodology for the trading test. The current methodology is well understood by firms and has the benefit of being simple, objective, and operationally embedded within compliance frameworks. Maintaining consistency in the methodology avoids the disruption and cost of re-engineering internal systems for what is ultimately a perimeter assessment tool.

We also welcome the FCA's proposal to raise the threshold. The previous level was not calibrated to reflect the current scale of commodity markets or the inflationary increases in underlying commodity prices and trading volumes. Without such an adjustment, there is a clear risk of regulatory drift, whereby more firms are captured over time despite no meaningful change in their real-world market footprint or systemic relevance.

However, CMCE believes that the FCA should also commit to a framework that ensures the threshold remains proportionate over time. For the annual monetary threshold (the AAT), that means an automatic, upward-only adjustment mechanism (as discussed in response to Q6). For the ratio-based trading test, while we strongly support the 50% level, we would encourage the FCA to keep the test under periodic review to confirm it continues to reflect the intended balance and does not lead to perimeter creep as market structures evolve. Any such review should operate on an upward-only basis, ensuring the ratio is not reduced in a way that could unintentionally tighten the perimeter.

In addition, CMCE reiterates its broader position that firms should be allowed to select the most appropriate test, including the trading test, based on their business model, rather than being forced to apply a single methodology. Preserving this flexibility is essential to ensuring that the perimeter test works fairly across a diverse range of commodity market participants.

In summary, CMCE supports both the retention of the trading test's methodology and the proposed increase to the threshold, provided this is embedded within a framework that ensures clarity, flexibility, and forward-looking adjustment. This should be complemented by ensuring that exchange-traded hedging activity, particularly on UK venues, is not inappropriately captured under other threshold calculations.

**Q8: Do you agree with the proposal to retain the calculation methodology for the capital-employed test and to raise the threshold? If not, please explain why.**

CMCE answer

CMCE supports the FCA's proposal to retain the existing calculation methodology for the capital-employed test. This approach has been in use for several years and is generally considered workable and proportionate by firms that choose to apply it. While not the most commonly used test across the commodity sector, it offers a useful alternative for certain business models, particularly those with well-defined capital structures and a clear separation between trading and non-trading activities.

We also agree with the proposal to raise the threshold, which is necessary to reflect both inflationary developments and the broader evolution of commodity markets since the original level was set. Without such an adjustment, firms may become inappropriately captured by the regime despite no fundamental change in the scale or nature of their trading activity. As with the trading test, CMCE believes this uplift is essential to prevent regulatory perimeter creep and to ensure that the test continues to reflect only genuinely non-ancillary activity.

That said, CMCE emphasises the importance of allowing firms to choose freely between the three available tests, annual threshold, trading, and capital employed, depending on which best reflects their operational and commercial structure. The capital-employed test will be more suitable for some firms than others, and its continued utility depends on it remaining optional rather than mandatory.

In summary, CMCE supports both the retention of the capital-employed test's methodology and the proposed threshold increase, provided the test remains optional and is supported by a stable, transparent framework for future indexation.